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While Indonesia was hardest hit by the Asian economic crisis, it has now entered a phase of development that, if well managed, will enable it to optimise the opportunities made available by globalisation. Such opportunities are made possible by the vertical specialization of labor and by the diffusion and development of information and communication technologies (ICTs). The infrastructure provided by the state has created significant opportunities in specific areas of manufacturing that can be realized, but the government has not paid adequate attention to the need to shape the regulatory framework appropriate to globalization. The promise made possible by the reduction in transportation and communication costs and the breaking down of barriers to the flow of goods, services, capital and knowledge is still not forthcoming due to an unimpressive regulatory regime. Various sections of the society have benefited from ICT products and services, but full realization of this sector's potential is hindered by PT Telkom's rent-seeking venture. Rather than functioning as a defender of the public interest to ensure the monopoly acts as if it were competitive, the government has allowed PT Telkom to raise price caps under the guise that it was necessary to allow Telkom to expand the number of connections in Indonesia. The government can realize Indonesia's ICT potential by establishing an independent telecommunications regulatory body (IRB) to monitor the competitive behavior of the telecommunication sector and by full implementation of the 1999 telecommunication law in a spirit of open and fair competition.

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Globalisation and the Indonesian Economy: Unrealised Potential

By Robert C. Rice[1] and Idris F. Sulaiman[2]

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Introduction

Globalisation has both caused difficulties and created opportunities for the Indonesian people. The openness of the economy proved to be a major problem when the Asian economic crisis struck in 1997. Indeed Indonesia was the country hardest hit a fact that suggests local issues had rendered the economy particularly vulnerable and that local regulatory agencies were far from adequate. Indonesia is now extracting itself from this crisis and has entered a phase of development that if well managed will enable the society to optimise the benefits opportunities made available by globalisation. Unfortunately, Indonesia has far from realised the steps needed to exploit these opportunities. In this chapter we seek to assist rectification of this situation by highlighting two areas we believe are critical to the nations' development effort and by stressing the need for the government to take appropriate steps to ensure an appropriate regulatory framework is in place. These are the opportunities made possible by the global vertical specialisation of labour and the growth and diffusion of information and communication technologies.

Globalisation and the Increased Vertical Division of Labour in Manufacturing

One potential benefit from globalisation available to Indonesia is increased foreign direct investment which can bring with it job creation, tax revenues, technology transfer, information about opportunities in export markets, and managerial know-how. From 1985 to 1997 foreign direct investment approvals increased from $1.06 billion to $33.82

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billion peaking in 1995 at 39.89 billion[3]. However, only a small percentage of the approved investment was actually realised — estimated at between 6% and 17% through 1997-2000 due often to the fact that the country did not have the institutional and regulatory structures in place that could ensure realisation of these opportunities (Gianie, p. 96). After 1997 both approved and realised FDI further decreased (See Table 1) as the investment situation deteriorated due to a decaying law and order environment and other adverse developments including an increase in the minimum wage (See SMERU Research Institute on the effects of minimum wage rates).

Table 1. Foreign Direct Investment in Indonesia

Year	Approvals ($ bill.)	Realised Net Private Direct Investment ($ mill.)
1985	1.06	
1995	39.89	4346
1996	29.94	6193
1997	33.82	4677
1998	13.59	- 356
1999	10.89	- 2754
2000	15.43	- 4451
2001	15.06	- 5877

Source: Bank Indonesia Website http://www.bi.go.id/bank_indonesia2/utama/data_statistik/data.asp?head=71), and Badan Koordinasi Penanaman Modal (December 2002), Table 1.

As can be seen from Table One, the poor state of capital inflow that has been approved is now on the increase but as of 2001 the situation in relation to realised investment remains

[3] Investment approval values are the sum of new projects, expansion of projects, and change of status of projects. Not included are foreign investments in oil and gas, banking, non-bank financial institutions, insurance and leasing.

dire. We suggest that this situation can be turned around if opportunities made possible by the global division of labour in the automobile, motorcycle, electric and electronic equipment industries are capitalised upon and if a regulatory framework suitable to a globalising economy is cemented in place and adequately managed. In short, if Indonesia does adopt the needed reforms it can capitalise on the decreased transportation and communications costs associated with globalisation and on the increased vertical division of labour in manufacturing between countries in accordance with their comparative advantages made possible by globalisation. It is this process that has increased the imported component content of finished manufactures in six of the largest developed countries from an unweighted average in 1950 of 5.3 percent to 26.3 percent in 1985 (Perraton, p. 145). In the case of Indonesia this vertical division of labour can result in producers of final goods in other countries electing to source labour-intensive intermediate inputs either through the establishment of new factories or by subcontracting to existing factories. This has happened already to a considerable degree in Malaysia (Rasiah and Edgington and Hayter).

What makes the situation especially opportune is the fact that Indonesia has already undertaken substantial infrastructure development designed to support the automobile and motorcycle industries and to a lesser extent the agricultural machinery and bicycle industries [4]. Vertical division of labour has already resulted in the growth of exports of some "Parts and Accessories Not Elsewhere Stated of Motor Vehicles" [Standard International Trade Classification (SITC) 784]. This has happened for several types of parts and accessories although for the whole category from 1988 to 2002 the value of net exports (exports minus imports) was negative and decreased from negative $375 million in 1988 to negative 889 million in 2000, and then became less negative[5]. Two items showing large increases were Road Wheels and Parts (SITC 784391), Radiators (SITC 784394) with net exports of $32.3 million and $36.5 million respectively in 2000, up

[4] This report is the second of two reports funded and published by the Japanese International Cooperative Agency as part of their technical assistance to Indonesia. They were both on the machinery parts and components, automotive parts and components, and electric and electronic parts and components industries. The first one was completed in March 1997.

[5] All export and import data are taken from Badan Pusat Statistik export and import yearbooks as shown in the Bibliography.

from $-4.4 million and $-2.0 million in 1990 and $10.7 and 24.2 million in 1994. There appears good potential for further exports of automotive parts and components (JICA, p. 4-86 to 4-88).

The motorcycle industry in Indonesia is generally considered to be more internationally competitive than the motor vehicle industry and a higher percentage of its component parts are produced in Indonesia. This resulted in rapid growth between 1988 and 1994 in exports of SITC group 785 (Motorcycles, Motor Scooters and Other Cycles Motorized and Non MT) but the industry then declined. Exports in millions of US dollars in 1988, 1992, 1994, 2000, and 2001 were 16, 110, 243, 227, and 170 respectively. Net exports however, have always been negative except for 1999, mainly because of the large net imports (imports minus exports) of SITC 78535910 (Parts and Accessories of Vehicle for Assembly Purposes) and SITC 78535990 (Other Parts of Motorcycles) that were $66 million and $150 million respectively in 2000. There has been little export of motorcycle component parts except those embodied in the motorcycles exported (net exports of $48 million in 1996, 60 million in 1998, and 38 million in 2000). Net exports of other bicycle parts increased from $2 million in 1992 to $92 million in 1994, were $91 million in 1997, decreased to $60 million in 1998 and stayed about the same thereafter. Indonesia has good potential for the production for export of some of the motorcycle and bicycle component parts because its large domestic market enables the realisation of economies of scale an important development given the ASEAN Free Trade Area (AFTA) is to commence in 2003.

Other export areas that have high promise exist in the electrical and electronic equipment industries. These are SITC 75 [office machines and automatic data-processing], SITC 76 [telecommunications and sound-recording and reproducing apparatus and equipment], and SITC 77 [electrical machinery, apparatus and appliances, n.e.s., and electrical parts thereof (including non-electrical counterparts, n.e.s., of electrical household-type equipment)]. As these industries require many components for their manufacture there are good possibilities for realising substantial gains from the global division of labour. For all three of these product groups there has been substantial progress in increasing exports especially since 1994 (Thee 1996, p. 24). Respectively, the net export values are large at $2.9 billion (SITC 75), $3.0 billion (SITC 76), and $1.3 billion (SITC 77) in

2000 and $1.9, $3.1, and $1.6 billion in 2001. By way of comparison the largest manufacturing industry in terms of net exports in 2000 and 2001 was clothing (SITC 84) at $4.7 and $4.5 billion respectively.

The rapid growth of Indonesian exports from the electric and electronic components industries in the 1990s is very encouraging. Foreign direct investors especially from Asia have played a leading role in increasing production and exports, mainly in the greater Jakarta and Batam island areas. The electrical and electronics components industry is dominated by Japanese enterprises (JICA, 3-28). It is important that the Indonesian Government continue to improve the investment climate for both local and foreign producers. Critical here is the need to permit 100% foreign capitalisation as it did in 1994. In the longer term these industries also need to be developed because they have the capacity to act as a vehicle enabling Indonesia to source higher technology exports.

Information Communication Technologies

There is little doubt Indonesia has the potential to accelerate and realise the benefits of information communications technology (ICT) and the knowledge-based economy. Here we argue that thus far the diffusion of the Internet and other ICT products and services has not been optimised primarily because of the inadequate regulatory system. This is part of a broader problem which we highlight by focussing on the ICT area. The lack of commitment to ICT regulatory reform by the government coupled with the lack of compliance on the part of the telecommunications incumbent has resulted in the less than impressive outcome of low E-readiness and other measurements of ICT diffusion. The section is divided into three parts: first, we detail Indonesia's e-readiness relative to other APEC member economies. We then provide an overview of the diffusion of ICTs in Indonesia and we identify some key policy impediments that have impeded the growth of ICTs. We close with some key recommendations that could put Indonesia on an open market path and enable ICTs to become instruments that empower and improve people's quality of life.

Globalisation and E-readiness

ICT is not a goal in itself but an instrument for development. A country's ICT diffusion can be measured by the e-readiness measurement. A recent study by APECTEL (2002)

on E-Commerce Readiness in 10 East Asian APEC Economies revealed Indonesia fared last[6]. While East Asia as a whole (average ranking of 3.00) needs to catch up with the ranking of leading nations (US at 4.36, G7 at 3.92), there is a clear gap between rich and poor economies. By contrast Indonesia with a score of 2.17 is not far behind Vietnam (2.28) and China (2.33). McConnell International's second E-Readiness report (May 2001) assessed 53 countries that represent over two-thirds of the world's population and the greatest potential markets. The countries are rated on a scale of Blue, Amber and Red. Indonesia ranked poorly achieving the last ranking of "red status".[7] Worse, in none of the five category of attributes is there any indication of improvements being made through "public-private partnership that are achieving E-Readiness impact" (McConnell International 2001: 13).

The E-Readiness assessment of 60 countries by the London-based Economist Intelligence Unit (EIU 2003) is based on the extent to which a country's business environment is conducive to Internet-based commercial opportunities. Indonesia ranked 53rd in this survey. One of the conclusions of the EIU survey was that the Asian countries that gained high E-Readiness rankings typically have adequate IT infrastructure, high per capita income, a significantly deregulated telecommunications sector, decreasing transaction costs, a pro-active government, a good education system and an openness towards trade and new ideas. In addition to creating an enabling environment, the countries that ranked highly such as South Korea, Singapore and Hong Kong have also introduced many "on-line" government services using the Internet through e-Government programs. Some of the difficulties in diffusing ICTs can be attributed to the recent

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[6] E-Readiness can be defined as "the aptitude of an economy to use Internet-based computers and information technologies to migrate traditional businesses into the new economy, an economy that is characterized by the ability to perform business transactions in real-time--any form, anywhere, anytime, at any price. E-Readiness reaches its optimal level when the economy is able to create new business opportunities that could not be done otherwise". The framework used in ranking covers both macro- and micro-economic factors that mirror the ability of an economy to compete in the new economy and the eight measurable sets of variables considered in the ranking are: Knowledgeable Citizen, Macro Economy, Industry Competitiveness, Ability and Willingness to Invest, Access to Skilled Workforce (Supply Skills), Digital Infrastructure, Culture, Cost of Living and Pricing (APECTEL, 2002).

[7] The McConnell "Global E-Readiness Summary" has three ranking representing various conditions necessary to support e-business and e-government. The 5 categories of ranking include infrastructure and access ("connectivity"), government policies ("e-leadership"" and "information security"), ICT education

economic crisis and its aftermath. There is little doubt these events can be linked with the poor state of Indonesia's E-readiness ranking. However, it can be argued that Indonesia's poor ranking is in fact a direct result of the strength of the monopoly power of its telecommunications operators. The telecommunications sector represents the "upstream" part of the ICT industries value chain continuum. As a result, cost structures in this segment of ICT directly affect the speed and spread of the diffusion of the Net which in Indonesia, principally runs on the telecommunications "backbone" network of the main incumbent, PT Telkom. Efforts to deregulate this sector have slowed since August 2002. However, before detailing these developments, we provide some evidence of the existing diffusion and tremendous potential in Indonesia's telecommunications regime.

II. ICT-Internet diffusion and their categories

This section provides survey data on the characteristics of Internet use in the general urban population and more specifically amongst small and medium enterprises (SMEs). The survey was undertaken by the Indonesian Internet Industry (IIBC, 2000) and examined 1500 respondents in 10 large urban cities. It was found most connections to the Internet are made by 26-35 year olds (38%), followed by 14-25 year olds (32%) and 36-55 year olds (30%). The largest group of users have a Bachelor Degree (39.6%) followed by High School students (34.5%), undergraduates (20.1%), and post-graduate students (5.7%). Occupationally, the largest users are private companies (43.0%), followed by civil servants (11%). The remaining users are entrepreneurs (10%), professionals (3%), housewives (1%), students (25%), and miscellaneous (6%).

The existence of Internet kiosks or Warnet in Indonesia is of significance to SME exporters. The section below describes the current usage pattern of e-commerce by SMEs and the nature of the benefits derived. We also identify barriers to greater use of Internet and e-commerce by SMEs. In a survey of 227 companies (50:50 small (5-25 employees) and medium (26-3000 employees) conducted by the Asia Foundation and Castle Asia Group (2002), 153 companies (or 67%) were found to have used the Internet.

("human capital"), and "e-business climate", and have 3 to 5 criteria to be measured in each category (McConnell International 2001)

Most (41%) started within 1-2 years prior to the survey and are maintaining strong growth with 20% joined in the last year.[8] Internet access is slow with 93% of user using dial-up connections because other connections are not available or are too expensive. Of companies surveyed 86% use Internet to access E-mail (90% with buyers and 48% with suppliers).

The technical implementation of the Telecommunication Law No. 39/1999 began in August 2002 when the two incumbents, PT Telkom and PT Indosat, were allowed to compete in both the domestic and international communications markets. PT Telkom commenced with an enormous advantage as it controlled almost all the telephone lines in the country and is the largest player in the ISP market. Given this situation it is critical that the Government as regulator ensures the two incumbents do not dominate the ISP market at the expense of retail customers and SMEs. This can be done by applying the Anti-Competition Law (1999) to state-owned companies such as PT Telkom or else by regulating competition through an independent telecommunications body. The Government should also open the market for global access so that charges on international bandwidth are reduced to the benefit of retail customers and SMEs.

PT Telkom has a particularly advantageous position in the ISP market and is gaining an ever greater market share (more than half as at January 2003) as it is able to offer combined ISP billing with its telephone service. With its "TelkomNet Instan" service, it can offer combined Internet/telephone pulse rate without a monthly subscription fee at a cost cheaper than other ISPs for low volume users who access the Internet for less than 15 hours a month. These services have placed an enormous competitive pressure on other ISPs and created an environment in which the industry is becoming monopolised and will continue to do so unless the government takes the steps needed to introduce and enforce a globally oriented competition policy.

In Indonesia, ISPs play a pivotal role in the diffusion of the Internet and in raising the public awareness of the potential of ICTs particularly in the regional cities and town. In January 2003, according to the ISP Association (APJII) the estimated number of Internet

[8] The Asia Foundation study is based on a survey in 12 cities on Java, Sumatra, Sulawesi, Kalimantan and

users reached 4.5 million and registered ISP subscribers reached 583,861. Of the total number of subscribers, 544,272 (93%) are domestic subscribers while the remaining 39,583 (or 7%) are from the corporate sector. The estimated number of Internet ISP subscribers stands at 583,861 at the end of 2002 according to the ISP Association (BI 24/1/03). Of the total number of subscribers, 544,272 (93%) are domestic and other subscribers while the remaining 39,583 (or 7%) are from the corporate sector. While the total number of fixed telephone lines owned by both categories has reached 7.807 million lines (see Table 3), future growth will come mainly from the new fixed wireless CDMA technology rather than from PSTN telephones. Nevertheless, it is curious that the data from PT Telkom shows that the projected growth will decline after 2003.

Discussion

As noted in opening this paper while Indonesia is the country that was hardest hit by the Asian economic crisis it has now entered a phase of development that if well managed will enable the society to optimise the opportunities made available by globalisation. We have sought to assist this process by highlighting some of the opportunities made possible by the vertical specialisation of labour and by focussing on the diffusion and development of information and communication technologies. We have argued that the infrastructure provided by the state has created significant opportunities in specific areas of manufacturing that can be realised. And by focussing on the Diffusion of the Internet and other ICT products and services in Indonesia we have highlighted the fact that the government has not paid adequate attention to the need to shape the regulatory framework to a form appropriate to globalisation. In short, the promise made possible by the reduction in transportation and communication costs, and the breaking down of barriers to the flow of goods, services, capital and knowledge is still not forthcoming as a result of an unimpressive regulatory regime.

Notwithstanding the limited diffusion of ICTs, various sections of the society, particularly small-medium enterprises and people from middle and upper income groups have benefited from ICT products and services. The main factors hindering the

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West Nusa Tenggara (Bali and Lombok) conducted between August and November 2001.

realization of this potential are related to PT Telkom's rent-seeking venture. Rather than functioning as a defender of the public interest to ensure the monopoly acts as if it were competitive, the government has allowed PT Telkom to raise price caps under the guise that the rise was necessary to allow Telkom to expand the number of connections in Indonesia. Given this situation, it is doubtful there will be any great increase in ICT diffusion until the government comes clean on its dealings with Telkom. Little can be expected from the current administration which is already preoccupied with the coming elections of 2004. Future governments, however, can realise Indonesia's potential by taking steps to rectify the prevailing situation by establishing an independent telecommunications regulatory body (IRB) to monitor the competitive behaviour of the telecommunication sector. Also required is the full implementation of the 1999 telecommunication law in a spirit of open and fair competition. This can only be achieved when a truly "modern licensing" system is implemented by the IRB to provide private independent operators in a fair and transparent manner.

In conclusion, we reiterate our key point this being that the opportunities for increased beneficial foreign direct investment have failed to be adequately capitalised on since the 1997 crisis mainly because of adverse domestic factors most notably the failure to establish a regulatory structure appropriate to globalisation. Some of the potential for increased benefits from the production of component parts for export to the global market is being realised, but much more could be realised.

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